State of Washington

New Issue Summary

Sale Date: On or about April 26, 2022, competitively

Series: $831,240,000 General Obligation Various Purpose Refunding Bonds, Series R-2022C; and $497,825,000 Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2022D. Par amounts are subject to change.

Purpose: Proceeds of the bonds will be used primarily to refund certain outstanding GO bonds in the State of Washington (the state).

Security: The state has irrevocably pledged its full faith, credit and taxing power to the GO bonds.

Washington's 'AA+' Long-Term Issuer Default Rating (IDR) and GO bond rating reflect the state's broad and steadily growing economy, with solid long-term revenue growth prospects, a demonstrated commitment to fiscal balance and combined long-term liabilities that place a low burden on resources. The ratings also reflect the state's very strong financial resilience supported by a statutory requirement for a balanced multiyear budget and formulaic funding of the budget stabilization account (BSA) leading to solid reserves. Education poses a unique spending pressure for the state given both steady population growth and the state's role as the primary funder for K–12 schools across the state.

Economic Resource Base: Washington's fundamental economic profile remains strong, with steady growth, particularly in IT, and a diverse employment base. Income levels are above the national average, and high educational attainment also supports continued economic gains.

Key Rating Drivers

Revenue Framework: 'aaa': Revenue performance over time has generally been above inflation, and Fitch Ratings expects this to continue to support solid growth prospects. The state has complete independent control over taxation, with an unlimited legal ability to raise operating revenues as needed.

Expenditure Framework: 'aa': Washington benefits from solid expenditure flexibility, although its flexibility is somewhat more restricted than most states due to court mandates, statutory commitments and broad responsibility for education funding. Rapid demographic growth also exerts pressure on infrastructure spending. The state has a low burden of carrying costs and benefits from the broad expense-cutting authority common to most U.S. states.

Long-Term Liability Burden: 'aaa': The combined burden of debt plus pensions is low as a percentage of personal income but above the median for U.S. states. Elevated debt ratios incorporate the funding of substantial capital needs, particularly for transportation, but are offset by a moderate net pension liability (NPL) and an expanding economic resource base.

Operating Performance: 'aa': Washington maintains very strong gap-closing capacity in the form of its superior budget flexibility and solid reserves. The state has prudently built up reserves in times of economic recovery and expansion despite spending pressure for education and other pressing needs.

Rating Sensitivities

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Strong economic and revenue growth that outpaces national GDP over time.
- Demonstrating the highest level of operating performance through the current economic recovery by managing higher spending for education and overall growth

FACT Tools

Ratings

Long-Term Issuer Default Rating	AA+

New Issues

$831,240,000 General Obligation Various Purpose Refunding Bonds, Series R-2022C	AA+
$497,825,000 Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2022D	AA+

Outstanding Debt

School Bond Guarantee Program	AA+
General Obligation Bonds	AA+
General Obligation Motor Vehicle Fuel Tax Bonds	AA+
General Obligation Motor Vehicle Fuel Tax and Vehicle-Related Fees Bonds	AA+

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (May 2021)

Related Research

Fitch Rates State of Washington's $1.3B GOs 'AA+'; Outlook Stable (April 2022)

State Liability Burdens Shrink in Fiscal 2020 (Surging Personal Income Drives Down Median) (November 2021)

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pressures while establishing superior gap-closing capacity, such as through building reserves toward the recent peak of 20% of spending.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A sustained increase in the long-term liability burden to 10% or more of personal income.
- An unanticipated shift in fiscal management that materially weakens fiscal resilience, such as sizable and continuing draws on reserves to support operations, particularly during times of economic expansion.

Current Developments

Economic Recovery Picks Up Pace

Washington's recovery from the coronavirus pandemic has been in line with national trends. As of March 2022, the state had recovered 90% of jobs lost in the first months of the pandemic, just slightly below the 93% national recovery. Washington had been lagging national trends more significantly, but the pace of jobs growth accelerated at a faster rate in 2H21 and into 2022. Headline unemployment of 4.2% in March was slightly above the national 3.8% rate that month, consistent with the pattern heading into the pandemic. Washington's labor force growth has been ahead of national trends, reflecting the state's ongoing economic expansion.

Washington Fiscal Update

Improving economic conditions and conservative initial forecasts have supported increases in the state's official revenue forecasts with four upward revisions over the past year. The most recent update from the state's Economic and Revenue Forecast Council (ERFC) in February projected fiscal 2022 and 2023 revenues at $5 billion more than the enacted budget for the 2021–2023 biennium. The ERFC primarily raised their outlook for the sales and use tax, the state's primary broad-based tax, and the business and occupations tax (B&O), a gross receipts tax levied on businesses. The council also made a notable upward revision to the real estate excise tax, reflecting the robust housing and commercial markets. Better-than-expected revenue performance continues a trend the state has experienced since soon after the pandemic's onset, primarily driven by the vast federal economic stimulus provided since March 2020.

Supported by the increased revenue forecast, as well as federal receipts from the American Rescue Plan Act (ARPA), the state enacted a supplemental 2022 budget bill last month that adds another approximately $5 billion in near general fund (NGF) appropriations for the current biennium. NGF is the designation for the state's primary operating funds. The additional appropriations are a mix of one-time allocations, such as a $2 billion transfer to the state's transportation fund, most of the $1.1 billion of allocated ARPA aid and recurring spending, such as $232 million for wage and compensation increases for state employees.

The state's budgetary reserves have shifted considerably through the pandemic and are now on a path toward restoring pre-pandemic levels. Reduced balances in the constitutional BSA were followed by a sharp increase in ending balance and now a projected decline as surplus revenues are appropriated (*as noted above*) in the supplemental 2022 budget bill noted earlier. The Washington Legislature also established a new reserve fund, the Washington Rescue Plan Transition Account (WRPTA), and allocated $1 billion toward it in fiscal 2022 in the enacted biennial budget. The supplemental 2022 budget bill adds another $1.1 billion next fiscal year. The WRPTA has statutory restrictions, although they are relatively broad, and the fund provides an important source of future fiscal flexibility for Washington.

In the current four-year budget outlook (a statutorily required budget forecast that reflects the supplemental 2022 budget bill), the state anticipates another net $500 million WRPTA deposit over the 2023–2025 biennium. By the end of the biennium, the budget outlook forecasts combined reserves (ending balance plus the BSA and WRPTA) of $4.2 billion, or approximately 13% of projected revenues and other resources. This compares to $6.5 billion at fiscal YE22, before the full effect of the supplemental budget bill, and a pre-pandemic peak of $3.6 billion at fiscal YE19.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	4/15/22
AA+	Affirmed	Stable	7/19/13
AA+	Affirmed	Negative	1/27/12
AA+	Revised	Stable	4/5/10
AA	Affirmed	Stable	12/31/08
AA	Affirmed	Positive	9/4/07
AA	Affirmed	Stable	4/13/06
AA	Downgraded	—	1/11/02
AA+	Upgraded	—	11/25/97
AA	Assigned	—	8/18/92

Credit Profile

Boeing remains a large employer in Washington and an important contributor to its economy; however, the state's overall manufacturing sector is about the same proportion of GDP as the nation's manufacturing sector, while Washington's IT sector generates over 2.5x the proportion of GDP as the nation. Microsoft and Amazon combined employ almost two times more individuals than Boeing, and several software and information companies continue to expand in the state. The workforce is highly educated, income levels are comparatively high and the state poverty rate is below the national average.

Revenue Framework

Washington relies on broad consumption-based revenues to fund operations and does not levy an income tax. This revenue mix results in collections that quickly reflect consumer spending and construction trends. Overall, general fund revenues exhibit a moderate level of volatility.

Washington's revenue structure is based on a retail sales and use tax (about half of total general fund–state revenues) and, to a much lesser extent, the B&O tax (about one fifth) and state property tax (approximately 15%). The property tax, unusual for a state, is statutorily dedicated to meeting the state's K–12 funding obligations. The importance of the real estate excise tax (5% of tax revenues in fiscal 2021) varies considerably depending on the point in the economic cycle. The state enacted a capital gains tax in 2021 that is forecast to generate about $500 million annually by fiscal 2025, equal to less than 2% of general fund–state revenues that year. The tax is currently being challenged in court.

This revenue structure makes the state budget especially sensitive to trends in consumer spending. In addition, construction (labor and materials) is assessed under the broad sales tax and receipts are significant to sales tax revenue performance, exposing the revenue stream to housing market volatility. Fitch expects revenues to continue to reflect cyclical trends, offset somewhat by the state's ongoing population growth and economic expansion.

Washington has complete independent legal ability to control taxes, a significant credit strength.

Expenditure Framework

As in most states, education and health and human services are Washington's largest operating expenses. Education is the larger line item, with state funding for local school districts and the public university and college system accounting for more than half of state general fund expenditures. Human services programs represent another third.

Washington's spending growth, absent policy actions, will likely be marginally above its solid revenue growth, requiring regular budget management to ensure ongoing balance. Education, specifically K–12, poses a particular pressure point. Several courts have interpreted the constitutional obligation to require significant investment by the state. Washington provides essentially full basic operational funding for K–12 school operations. Since the 2011–2013 biennium, K–12 state funding has more than doubled. Local districts can levy their own taxes to supplement state aid.

The fiscal challenge of Medicaid is common to all U.S. states and the nature of the program, as well as federal government rules, limit the states' options in managing the pace of spending growth. As with all federal initiatives, Medicaid remains subject to regulatory changes that could affect various aspects. However, federal action to revise Medicaid's fundamental programmatic and financial structure does not appear to be a near-term priority of the current federal administration or congressional leadership.

Washington retains solid expenditure flexibility. While Medicaid costs are somewhat beyond the state's ability to materially change given federal requirements for the program, the state's carrying costs for long-term liabilities are low. Like most states, Washington's operating budget (outside of Medicaid) goes largely toward funding of services rather than direct service delivery, allowing the state to shift costs to lower levels of government in times of fiscal stress. This is true even for education spending, as the state appropriates money to local school districts rather than operating any schools itself.

Long-Term Liability Burden

On a combined basis, Washington's burden of direct debt and adjusted NPLs, at 5.8% of personal income, is above the 4.7% median for U.S. states (both per Fitch's November 2021 "State Liability Burdens Shrink in Fiscal 2020" report) but still low overall. Debt levels are twice the U.S. state median, reflecting in part the demands of many years of strong population growth. However, pension liabilities are below the median. Using updated information from the state's fiscal 2021 annual comprehensive financial report, the burden is in line with prior year at 5.5%. Fitch expects the combined burden to remain at similar levels despite large capital needs given strong population and personal income growth.

Washington's outstanding debt equals about two thirds of Fitch-adjusted long-term liabilities and primarily comprises GO bonds. Capital needs are substantial, particularly for transportation, and future borrowing is anticipated. The state has repeatedly demonstrated its ability and willingness to raise revenues in support of transportation capital investment, most recently through an electrification fee for electric vehicles and an increase to the service fee for vehicle title transactions and registration. Tolling is also utilized as part of the funding solution.

In fiscal 2021, Washington's aggregate fiduciary pension assets fully covered total pension liabilities on a reported basis, assuming a 7.5% investment return for most of the plans. This ratio falls to an estimated 84% using Fitch's standard 6% investment return assumption. The state has made changes to manage pension costs, including the elimination of cost of living adjustments. Washington has deferred full contributions to the closed pension systems in times of economic strain. Other post-employment benefits (OPEB) are limited and funded on a pay-as-you-go basis.

Contingent liabilities include the school bond guarantee program (SBG), which provides a GO guarantee to outstanding school district debt. The state utilized the enhancement for the first time ever on June 1, 2021, to advance approximately $3.2 million due to an internet connectivity issue with the county's bank delaying debt service transfers for school districts in Mason County. The county made the transfer within the same day, fully covering the state's advance.

Fitch continues to exclude the covered school district debt from its long-term liability calculation, as the agency considers the recent advance to be a very short-term issue, affecting only a minimal portion of the contingent liability and not indicative of any ongoing need for state advances.

Operating Performance

Frequent reviews of economic and financial forecasts allow the state to respond effectively to changing conditions. During the Great Recession and the recent pandemic-driven downturn, the state demonstrated its willingness and ability to utilize broad budget flexibility in response. In fiscal years 2009 through 2011, the state implemented a combination of ongoing and one-time actions and fully depleted accumulated reserves. In 2020, the state implemented spending cuts and planned reserve draws, although the ultimate draws on reserves were much less than planned at the outset of the pandemic. Fitch expects the state to similarly make use of its very strong gap-closing capacity supported by its solid, reinstated reserve position during future cyclical downturns.

Budgeting can be challenging, in part due to the spending pressures noted earlier for education and growth needs coupled with a statutory mandate that the budget show projected balance over the four-year budget outlook period, rather than just the current biennium. Positively, the state took advantage of growth leading into the pandemic to rebuild financial flexibility, primarily by adding steadily to reserves.

The state has solid funding provisions for its BSA, which supports the building of financial flexibility. This constitutional account receives the first 1% of revenues collected every year until it reaches its cap of 10% of annual general revenues. Furthermore, 75% of extraordinary growth in state revenue (defined as growth in general state revenues that exceed by one third the average biennial growth of the prior five biennia) must be transferred to the BSA on top of the 1%. This measure also serves to limit the effect of revenue volatility on the operating budget. The new WRPTA provides an additional source of fiscal reserves, with less restrictions on accessing it than the BSA. Given its flexibility, Fitch considers the WRPTA to be a component of the state's budgetary reserves.

Washington's initiative and referendum environment creates a level of operating and financial uncertainty. However, it is significant that any law approved by voters in this manner can be amended or repealed by the legislature by a two-thirds vote in the first two years after approval and by a simple majority thereafter. The legislature repeatedly has shown the ability and willingness to suspend initiatives. The state constitution may not be amended by initiative or referendum.

School Bond Guarantee Program Details

The 'AA+' rating on the school credit enhancement program, or SBG, reflects Washington's full faith, credit and taxing power pledge to guarantee full and timely payment of P&I on the debt of participating school districts. As of April 1, 2022, the aggregate total principal amount outstanding on 461 voter-approved bond issues guaranteed under the program was $16 billion. The bonds were issued by 170 school districts.

The program has both a constitutional and statutory basis in state law, including Article VIII, Section 1 (e) of the state constitution and the Revised Code of Washington, Title 39, Chapter 98. The statute also outlines the mechanics of the state's GO guarantee. County treasurers collect property taxes used for debt service, transferring them to paying agents. The school district, the county treasurer and the paying agent all bear responsibility for contacting the state treasurer in the event of a shortfall. Notification requirements provide sufficient time for the state treasurer to forward payments to the paying agent prior to debt service due dates. The authorizing statute provides that the state legislature must appropriate, in each and every biennial appropriations act, the amount needed to make timely payment on any SBG bonds.

For fiscal 2022, the state estimates total debt service on SBG bonds of $1.6 billion. The state's backstop is not linked to or limited by state aid distributions due to any particular school district.

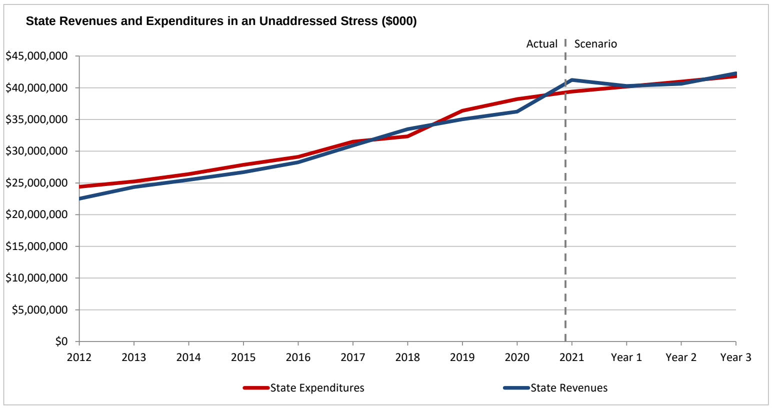
ESG Considerations

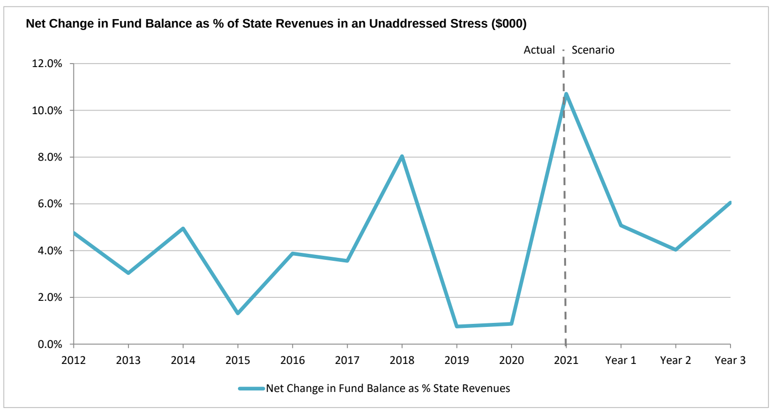
Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, due to either their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Washington, State of (WA)

Scenario Analysis

Ver 36





Analyst Interpretation of Scenario Results

Frequent reviews of economic and financial forecasts allow the state to respond effectively to changing conditions. During the Great Recession and the recent pandemic-driven downturn, the state demonstrated its willingness and ability to utilize broad budget flexibility in response. In fiscal 2009 through fiscal 2011, the state implemented a combination of ongoing and one-time actions, and fully depleted accumulated reserves. In 2020, the state implemented spending cuts and planned reserve draws, though the ultimate draws on reserves were much less than planned at the outset of the pandemic. Fitch expects the state to similarly make use of its very strong gap-closing capacity, supported by its solid, reinstated reserve position, during future cyclical downturns.

Scenario Parameters:		Year 1	Year 2	Year 3
GDP Assumption (% Change)		(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)		2.0%	2.0%	2.0%
Revenue Output (% Change)	*Minimum Y1 Stress:* -1% *Case Used:* **Moderate**	(2.3%)	0.9%	4.1%

Revenues, Expenditures, and Net Change in Fund Balance	Actuals										Scenario Output		
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Year 1	Year 2	Year 3
Expenditures													
Total Expenditures	36,290,000	37,111,000	39,553,000	42,571,000	44,146,954	46,876,157	47,989,794	52,338,056	55,661,482	63,132,310	64,394,956	65,682,855	66,996,512
% Change in Total Expenditures	(1.1%)	2.3%	6.6%	7.6%	3.7%	6.2%	2.4%	9.1%	6.3%	13.4%	2.0%	2.0%	2.0%
State Expenditures	24,385,000	25,222,000	26,385,000	27,859,000	29,113,421	31,506,179	32,343,483	36,374,765	38,221,995	39,392,543	40,180,394	40,984,002	41,803,682
% Change in State Expenditures	1.2%	3.4%	4.6%	5.6%	4.5%	8.2%	2.7%	12.5%	5.1%	3.1%	2.0%	2.0%	2.0%
Revenues													
Total Revenues	34,430,000	36,250,000	38,649,000	41,399,000	43,294,691	46,269,050	49,114,776	50,993,434	53,683,175	64,976,549	64,488,960	65,323,453	67,472,018
% Change in Total Revenues	(1.5%)	5.3%	6.6%	7.1%	4.6%	6.9%	6.2%	3.8%	5.3%	21.0%	(0.8%)	1.3%	3.3%
Federal Revenues	11,905,000	11,889,000	13,168,000	14,712,000	15,033,533	15,369,978	15,646,311	15,963,291	17,439,487	23,739,767	24,214,562	24,698,854	25,192,831
% Change in Federal Revenues	(5.5%)	(0.1%)	10.8%	11.7%	2.2%	2.2%	1.8%	2.0%	9.2%	36.1%	2.0%	2.0%	2.0%
State Revenues	22,525,000	24,361,000	25,481,000	26,687,000	28,261,158	30,899,072	33,468,465	35,030,143	36,243,688	41,236,782	40,274,398	40,624,599	42,279,188
% Change in State Revenues	0.8%	8.2%	4.6%	4.7%	5.9%	9.3%	8.3%	4.7%	3.5%	13.8%	(2.3%)	0.9%	4.1%
Excess of Revenues Over Expenditures	(1,860,000)	(861,000)	(904,000)	(1,172,000)	(852,263)	(607,107)	1,124,982	(1,344,622)	(1,978,307)	1,844,239	94,004	(359,402)	475,506
Total Other Financing Sources	2,932,000	1,601,000	2,165,000	1,524,000	1,948,380	1,707,652	1,567,704	1,608,643	2,293,902	2,572,586	1,950,097	1,998,586	2,084,763
Net Change in Fund Balance	1,072,000	740,000	1,261,000	352,000	1,096,117	1,100,545	2,692,686	264,021	315,595	4,416,825	2,044,102	1,639,184	2,560,269
% Total Expenditures	3.0%	2.0%	3.2%	0.8%	2.5%	2.3%	5.6%	0.5%	0.6%	7.0%	3.2%	2.5%	3.8%
% State Expenditures	4.4%	2.9%	4.8%	1.3%	3.8%	3.5%	8.3%	0.7%	0.8%	11.2%	5.1%	4.0%	6.1%
% Total Revenues	3.1%	2.0%	3.3%	0.9%	2.5%	2.4%	5.5%	0.5%	0.6%	6.8%	3.2%	2.5%	3.8%
% State Revenues	4.8%	3.0%	4.9%	1.3%	3.9%	3.6%	8.0%	0.8%	0.9%	10.7%	5.1%	4.0%	6.1%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.